

Message Text

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ACTION NEA-10

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TO SECSTATE WASHDC 8052

INFO AMEMBASSY LONDON

C O N F I D E N T I A L SECTION 1 OF 3 TEHRAN 4025

EO 11652: GDS

TAGS: ENRG, BGEN, IR

SUBJ: NIOC/CONSORTIUM NEGOTIATIONS

REF: TEHRAN 3589

1. AMBASSADOR WAS BRIEFED APRIL 27 ON STATUS OF ONGOING NIOC/CONSORTIUM NEGOTIATIONS BY ELTON YATES, TEXACO OFFICIAL AND MEMBER OF CONSORTIUM NEGOTIATING TEAM, AND WARREN GLOSS, GENERAL MANAGER OF IRAN OIL PARTICIPANTS- I.E. THE CORPORATE ENTITY KNOWN AS CONSORTIUM. CONSORTIUM OFFICIAL S REPORTED THAT GENERAL AGREEMENT HAS BEEN REACHED ON SOME POINTS BUT THAT THE TWO SIDES SEEM TO HAVE REACHED A TEMPORARY IMPASSE ON CERTAIN CRUCIAL SPECIFICS.

2. PERHAPS IN ANTICIPATION OF LONG DRAWN OUT NEGOTIATIONS, NIOC HAS REQUESTED THE CONSORTIUM TO TAKE STEPS IMMEDIATELY WITHOUT WAITING FOR COMPLETION OF NEGOTIATIONS. ONE SUCH REQUEST IS FOR THE CONSORTIUM TO EXPORT AN AVERAGE OF 3.3 MMBPD OF CRUDE DURING CALENDAR 1978. (THIS WOULD SUGGEST THAT GOI WANTS TO EXPORT ABOUT 5.1 MMBPD OF CRUDE OIL THIS YEAR.) GIVEN SOFT
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MARKET CONDITIONS AND THE FACT THAT CONSORTIUM OFF-TAKE DURING THE FIRST QUARTER WAS ONLY 2.9 MMBPD, THE CONSORTIUM HAS REFUSED TO CONSIDER MAKING ANY SPECIFIC LIFTING COMMITMENT THAT IS NOT PART OF A COMPLETELY RENEGOTIATED COMPRE-
HENSIVE AGREEMENT. OBVIOUSLY, NIOC AND GOI ARE CONCERNED ABOUT THE FACT THAT CRUDE EXPORTS DURING THE

FIRST QUARTER OF 1978 WERE 4.6 PERCENT LOWER THAN DURING THE CORRESPONDING PERIOD OF 1977.

3. NIOC HAS ALSO DEMANDED THAT THE CONSORTIUM RESUME EXPORTING UP TO 300 MBPD OF REFINED PRODUCTS FROM ABADAN REFINERY. NIOC MAINTAINS THAT THE CONSORTIUM HAD NO LEGAL RIGHT TO TERMINATE, AS THE CONSORTIUM DID ON JANUARY 1, 1978, THE ABADAN PROCESSING AGREEMENT WHICH IS PART OF THE 1973 3 -,\$ 047:#- 3 -&433.3,5; AND, WHICH HAD COMMITTED THE CONSORTIUM TO PROCESS UP TO 300 MBPD AT ABADAN REFINERY AND TO EXPORT AN EQUIVALENT AMOUNT OF PRODUCTS (ALMOST EXCLUSIVELY FUEL OIL) WHICH WERE EXCESS TO IRAN'S DOMESTIC CONSUMPTION REQUIREMENTS. THE CONSORTIUM'S POSITION IS THAT A) THE PROCESSING AGREEMENT GIVES IT THE RIGHT, BY GIVING TWO YEARS NOTICE, TO REDUCE (EVEN TO ZERO) THE AMOUNT OF CRUDE PROCESSED, B) IT DID GIVE THE NOTICE IN THE FORM REQUIRED IN 1976 OF ITS INTENTION TO STOP PROCESSING ON JANUARY 1, 1978, C) IT CANNOT AFFORD TO RESUME PROCESSING BECAUSE IT WOULD LOSE APPROXIMATELY 100 MILLION DOLLARS PER YEAR, (COMMENT: THE PROCESSING AGREEMENT IN EFFECT REQUIRES THE CONSORTIUM TO ACCEPT A SPECIFIC QUANTITY OF LOW VALUE FUEL OIL AND TO PAY FOR AN EQUIVALENT QUANTITY OF CRUDE AT REGULAR CONSORTIUM PRICES AS WELL AS TO PAY HIGH REFINING COSTS ON THIS CRUDE.), AND D) THE INDIVIDUAL MEMBERS OF THE CONSORTIUM

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ARE WILLING TO HELP NIOC BY BUYING FUEL OIL AT THE SAME PRICES WHICH PREVAIL ELSEWHERE IN THE PERSIAN GULF.

4. NIOC HAS VERY REASON TO TRY TO FORCE THE CONSORTIUM TO RESUME FUEL OIL EXPORTS ON THE HIGHLY ADVANTAGEOUS TERMS, TO NIOC, WHICH ARE PART OF THE 1973 AGREEMENT, ESPECIALLY SINCE NIOC HAS BEEN SO UNSUCCESSFUL IN DOING ITS OWN PRODUCT MARKETING. A SENIOR NIOC OFFICIAL TOLD PETOFF THAT A) 7.5 MMBBLS OF FUEL OIL ARE STORED AT ABADAN, B) NIOC HAS HAD TO REDUCE THROUGHPUT AT ABADAN REFINERY TO ONLY SLIGHTLY OVER 400 MBPD IN ORDER TO REDUCE FUEL OIL PRODUCTION, C) NIOC HAS HAD TO IMPORT TWO TANKER LOADS OF MIDDLE DISTILLATE FROM KUWAIT SINCE THE REDUCTION IN THROUGHPUT AT ABADAN, WHILE HELPING TO ALLEVIATE THE EXCESS FUEL OIL PROBLEM, HAD CREATED SHORTAGES OF MIDDLE DISTILLATES, AND D) NIOC MARKETING DIVISION HAS INSUFFICIENT AUTHORITY TO LOWER FUEL OIL PRICES ENOUGH TO MOVE THE EXCESS INVENTORIES AND ALSO LACKS THE COURAGE TO ATTEMPT TO CONVINCE NIOC MANAGING DIRECTOR ANSARY THAT LARGE PRICE CUTS MUST BE MADE.

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5. ACCORDING TO YATES, ANSARY HAS THREATENED TO GO TO ARBITRATION IN ORDER TO FORCE CONSORTIUM TO ADHERE TO THE TERMS OF THE PROCESSING AGREEMENT AND TO RESUME PRODUCT EXPORTS. CONSORTIUM'S RESPONSE HAS BEEN THAT NIOC CAN DO AS IT CHOOSES AND THAT NIOC WILL NOT BE ABLE TO MAKE A CASE. ANOTHER, PERHAPS EVEN MORE LIKELY, APPROACH TO THE FUEL OIL PROBLEM THAT WAS RAISED BY ANSARY WITH THE CONSORTIUM NEGOTIATING TEAM IS THE POSSIBILITY OF BLENDING FUEL OIL INTO EXPORT CRUDE STREAMS. IF NIOC WERE TO DO THIS WITHOUT FIRST HAVING REACHED AGREEMENT WITH ITS CRUDE CUSTOMERS ON HOW MUCH THE PRICE SHOULD BE REDUCED, GREAT ANIMOSITY AND LEGAL COMPLICATIONS WOULD BE CREATED BETWEEN NIOC AND ALL OF ITS CRUDE CUSTOMERS.

6. DESPITE CONTINUED INTRANSIGENCE ON THE POINTS OUTLINED ABOVE, SOME PROGRESS HAS BEEN MADE IN THE NEGOTIATIONS IN THE PAST TWO WEEKS. NIOC IS REPORTEDLY WILLING TO ACCEPT FULL RESPONSIBILITY FOR ALL EXPENDITURES, CAPITAL INVESTMENT, AS WELL AS OPERATING COSTS, NECESSARY IN THE KHUZESTAN OIL FIELDS. ACCORDING TO THE TERMS OF THE 1973 AGREEMENT, THE CONSORTIUM IS COMMITTED TO LEND TO NIOC 40 PERCENT OF THE CAPITAL

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INVESTMENT BUDGET OF THE KHUZESTAN FIELDS. HOWEVER, NIOC RECOGNIZED OVER TWO YEARS AGO THAT THE CAPITAL DEVELOPMENT BUDGET HAD GOTTEN SO LARGE THAT THE CONSORTIUM HAD TO BE RELIEVED OF WHAT HAD, OR WOULD HAVE SHORTLY, CAUSED AN INTOLERABLE NEGATIVE CASH FLOW SITUATION FOR THE CONSORTIUM. CONSEQUENTLY, NIOC HAS ALLOWED THE CONSORTIUM TO MAKE INTEREST PAYMENTS FOR THE PAST TWO-PLUS YEARS ON THE AMOUNTS THAT ARE DUE NIOC ACCORDING TO THE 1973 AGREEMENT. NIOC HAS AGREED, IN PRINCIPAL AT LEAST, THAT THE CONSORTIUM WILL BE RELIEVED OF ALL FINANCIAL RESPONSIBILITY INCLUDING THE INTEREST PAYMENTS WHICH ARE CURRENTLY ABOUT 7-8 MILLION DOLLARS MONTHLY, WHEN THE NEW AGREEMENT COMES INTO FORCE.

7. NIOC AND THE CONSORTIUM HAVE ALSO COME TO GENERAL AGREEMENT ON OFFTAKE BUT MANY DETAILS REMAIN TO BE WORKED OUT. GENERAL AGREEMENT EXISTS THAT THE OFFTAKE AGREEMENT (MORE PRECISELY, THE PROVISIONS RELATING TO OFFTAKE IN A NEW OR REVISED COMPREHENSIVE AGREEMENT). WILL BE VALID UNTIL 1993 AND WILL NOT ENTITLE THE CONSORTIUM TO ANY PRICE DISCOUNTS. THE CONSORTIUM AND NIOC HAVE BEEN TALKING ABOUT THE QUANTITIES OF CRUDE THAT WOULD BE MADE AVAILABLE BY NIOC AND WHICH THE CONSORTIUM WOULD BE COMMITTED TO EXPORT DURING THE FIRST FIVE YEARS OF THE NEW AGREEMENT. INsofar AS THE EMBASSY IS AWARE, NO FIGURE HAS BEEN AGREED UPON BUT WE EXPECT THAT AGREEMENT WILL PROBABLY BE REACHED AT ABOUT 3.0 MMBPD. THE CONSORTIUM HOPES TO OBTAIN A COMMITMENT FROM NIOC TO GUARANTEE THE CONSORTIUM ACCESS TO AT LEAST HALF OF THE CRUDE AVAILABLE FOR EXPORT BETWEEN 1983 AND 1993, AND TO NEGOTIATE THE SPECIFIC AMOUNT LATER. NIOC IS REPORTEDLY THINKING OF GUARANTEEING THE CONSORTIUM THAT IT WILL BE ENTITLED TO EXPORT UP TO HALF OF CRUDE AVAILABILITIES AND TO SETTLE

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ON THE SPECIFIC AMOUNT LATER. BEFORE THE TWO SIDES MAKE ANY FURTHER PROGRESS ON SPECIFYING THE QUANTITIES OF CRUDE TO BE EXPORTED OR MADE AVAILABLE TO THE CONSORTIUM FOR EXPORT, THEY MUST ADDRESS SOME OTHER ISSUES ON WHICH THEY HAVE, THUS FAR, BEEN UNABLE TO SECURE EVEN A PARTIAL CONSENSUS. THESE INCLUDE, INTERALIA, A) FINANCIAL PENALTIES FOR UNDERLIFTING (WHETHER TO HAVE THEM AND, IF SO, HOW SEVER), B) PHASE-IN, PHASE-OUT PROVISIONS, AND C) PROVISIONS TO PROVIDE CONSORTIUM SOME ASSURANCE THAT IRANIAN CRUDE PRICES WILL BE COMPETITIVE.

8. THE OTHER BASIC ELEMENT OF ANY NEW AGREEMENT WILL RELATE TO SERVICES; AND NIOC AND THE CONSORTIUM,) WHILE RECOGNIZING THE NECESSITY AND/OR DESIRABILITY OF HAVING

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THE CONSORTIUM PROVIDE TECHNICAL SERVICES, HAVE NOT MADE MUCH PROGRESS IN DEFINING HOW AND AT WHAT PRICE. THE CONSORTIUM'S BASIC POSITION IS THAT THEY ARE ENTITLED TO A PER BARREL FEE ON EVERY BARREL THEY PRODUCE OR AT LEAST ON EVERY BARREL THEY PRODUCE THAT IS SUBSEQUENTLY EXPORTED-WHETHER BY THE CONSORTIUM OR NOT AND WHETHER AS CRUDE OR PRODUCT. NIOC IS REPORTEDLY OFFERING TO PAY A SERVICES FEE ONLY ON THE QUANTITIES THAT THE CONSORTIUM EXPORTS. THE U.S. MEMBERS OF THE CONSORTIUM WILL BE ADAMANT ON THIS POINT SINCE THEY WOULD LOSE MOST OF ALL U.S. TAX CREDITS IF THE FEES WERE CALCULATED ON QUANTITIES EXPORTED BY THE CONSORTIUM-SUCH A FEE WOULD BE VIEWED AS A SIMPLE DISCOUNT. EVEN WHEN THIS ISSUE IS RESOLVED, THE CRUCIAL AND DIFFICULT QUESTION OF HOW MUCH NIOC WILL PAY FOR TECHNICAL SERVICES WILL REMAIN. ACCORDING TO YATES, THE TWO SIDES ARE ABOUT 100 MILLION DOLLARS APART AND ARE NOT MOVING ANY CLOSER TOGETHER. OTHER ISSUES RELATED TO THE SERVICES AGREEMENT THAT MUST BE RESOLVED INCLUDE A) THE PACE AT WHICH NIOC AND IRANIAN STAFF TAKE-OVER AND B) HOW TO REIMBURSE THE CONSORTIUM FOR ACTIVITIES RELATED TO EXPLORATION, NATURAL GAS PROCESSING, ETC.

9. A FINAL ISSUE WHICH HAS BEEN PROVISIONALLY SETTLED IS
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HOW TO CLOSE THE BOOKS RELATING TO THE ABADAN PROCESSING AGREEMENT. THIS WAS A COMPLICATED ISSUE BECAUSE THE PROCESSING AGREEMENT DID NOT SPECIFICALLY ADDRESS WHAT WOULD HAPPEN IF AND WHEN THE CONSORTIUM STOPPED PROCESSING; AND THE TWO SIDES ARGUED FOR A LONG TIME OVER THE OWNERSHIP AND VALUE OF REFINERY STOCKS. HOWEVER, A COMPROMISE WAS FOUND WHICH THE CONSORTIUM WOULD LIKE TO SIGN AND IMPLEMENT IMMEDIATELY. NIOC, ALTHOUGH IT HAS AGREED THAT THE COMPROMISE IS REASONABLE AND EQUIPTABLE, HAS REFUSED TO SIGN UNTIL ADDITIONAL PROGRESS IS MADE ON THE OTHER, MORE IMPORTANT ISSUES.

1. IN SUMMARY, NIOC AND THE CONSORTIUM HAVE MADE SOME PROGRESS BUT FINAL AGREEMENT IS CERTAINLY NOT IMMINENT. YATES AND GLOSS SAID THAT EVERYTHING THAT COULD BE SAID BY EITHER SIDE AT THIS POINT HAS BEEN, AND THAT THE LOGICAL THING TO DO IS RECESS IN ORDER TO GIVE BOTH SIDES THE OPPORTUNITY TO CONSIDER THEIR NEXT STEPS. YATES AND GLOSS ALSO CONFIRMED THAT AN EXTREMELY FRIENDLY ATMOSPHERE CONTINUES TO EXIST BETWEEN THE TWO NEGOTIATING TEAMS. ON THE NIOC SIDE, ALMOST ALL OF THE MEETINGS OF THE PAST TWO WEEKS HAVE BEEN CHAIRED (VERY ABLY, ACCORDING TO CONSORTIUM OFFICIALS) BY MEHRAN, THE NEW DEPUTY MANAGING DIRECTOR FOR COMMERCIAL AND FINANCIAL AFFAIRS; BUT THE CONSORTIUM TEAM ALSO MET WITH ANSARY ON A COUPLE OF OCCASIONS.

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